COMMENTS

THE HALFWAY POINT BETWEEN BARBARY COAST AND SHANGRI-LA: EXTRATERRITORIALITY AND THE VIABILITY OF THE ECONOMIC REALITY METHOD POST-*PARKCENTRAL GLOBAL HUB LTD. V. PORSCHE AUTOMOBILE HOLDINGS SE*

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In the increasingly globalized world, courts have struggled with how to best determine whether a security transaction is sufficiently domestic for § 10(b) of the Securities and Exchange Act of 1934 to apply. The leader in securities regulation jurisprudence, the U.S. Court of Appeals for the Second Circuit, held in Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE *that, although satisfying the location-based transactional test the Supreme Court established in* Morrison v. National Australia Bank *is required, it is not, on its own, dispositive of § 10(b) liability.*

*This Comment argues that post-*Parkcentral *courts should use a new, two-step test to analyze the extraterritoriality of securities transactions. Courts should first perform the* Morrison *transactional test followed by the sufficiency test the Second Circuit established in* Parkcentral. *In so doing, courts should evaluate a variety of factors and, based on the totality of the circumstances,*

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determine whether § 10(b) applies. The test advocated by this Comment will strengthen Morrison*'s presumption against extraterritoriality by providing courts with more tools to analyze cases with foreign elements.*

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INTRODUCTION

In the increasingly globalized world, will the United States become the Barbary Coast for securities transactions where fraudsters easily flout U.S. securities regulations by finding holes in the law's narrow interpretation? Or will the United States become a Shangri-La where foreign plaintiffs who claim fraud on the foreign securities market flock to U.S. courts, despite their cases having little actual connection to the United States?

Since the 1970s, U.S. courts have been trying to find a balance between the two extremes in U.S. securities regulation. In the seminal case *Morrison v. National Australia Bank Ltd.*,[1] the Supreme Court ruled that § 10(b) of the Securities and Exchange Act of 1934 (Exchange Act)[2] has no extraterritorial reach.[3] Courts must perform a location-based transactional test to determine whether the transaction is sufficiently domestic to incur § 10(b) liability.[4] However, with the growing prevalence of globalization and modern technology, that line is increasingly harder to draw. Securities markets can now operate fluidly across international borders with many parties conducting their transactions electronically.[5] Some security instruments, like securities-based swap agreements or American Depositary Receipts, can have attenuated connections to the location of the transaction.[6] Due to this trend, courts have struggled to create a clear but flexible rule that can adequately address the variety of securities instruments.

In the summer of 2014, the U.S. Court of Appeals for the Second Circuit, the leader in securities regulation jurisprudence,[7] made an

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1. 561 U.S. 247 (2010).

2. *See* Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012) (prohibiting fraud in any transaction of regulated securities).

3. *See Morrison*, 561 U.S. at 265 (explaining that § 10(b) does not overcome the presumption against extraterritoriality).

4. *See id.* at 267, 269–70 (outlining two factors for determining liability: (1) whether the transaction is conducted in the United States, or (2) whether it involves a security listed on a domestic exchange).

5. *See Second Circuit Holds that Transactions in Unlisted Securities Are Domestic if Irrevocable Liability Is Incurred or if Title Passes Within the United States*, 126 HARV. L. REV. 1430, 1436 n.56 (2013) [hereinafter *Second Circuit Holds Transactions Domestic*] (noting that over-the-counter securities transactions are conducted electronically and over the telephone).

6. *See id.* at 1436 (speculating that the *Absolute Activist* domestic transaction test could still lead to inconsistencies because transaction location is arbitrary for some types of securities).

7. *See Morrison*, 561 U.S. at 260 (remarking that, although the U.S. Court of Appeals for the District of Columbia Circuit criticized the U.S. Court of Appeals for

important step towards finding that middle ground. *Parkcentral Global Hub Ltd. v. Porsche Automobile Holdings SE*[8] was a § 10(b) case regarding securities-backed swap agreements[9] where the underlying security was foreign.[10] The U.S. District Court for the Southern District of New York used the economic reality method to determine that § 10(b) did not cover plaintiffs' claims.[11] In affirming the district court, the Second Circuit approached the issue differently, addressing the issue of whether the transactional test controlled.[12] The court ultimately diverged from the bright-line traditional understanding of the transactional test,[13] holding that, even if the plaintiffs had satisfied the *Morrison* transactional test, the transaction lacked a sufficient connection to the United States to satisfy § 10(b).[14]

With its holding in *Parkcentral*, the Second Circuit created a major shift in extraterritorial considerations in securities law jurisprudence.[15] No longer can courts rely solely on the transactional test to determine whether a case can be brought under § 10(b). The *Parkcentral* court, however, left some issues unresolved.[16] Most

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the Second Circuit's conduct-and-effects test, it felt obligated to defer to the court's accepted expertise); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 762 (1975) (Blackmun, J., dissenting) (referring to the Second Circuit as the "Mother Court" of securities law); SEC v. A Chi. Convention Ctr., LLC, 961 F. Supp. 2d 905, 917 (N.D. Ill. 2013) (applying the Second Circuit's domestic transaction test from *Absolute Activist* to the facts of the case); Richard A. Grossmann, *The Trouble with Dicta:* Morrison v. National Australia Bank *and the Securities Act*, 41 SEC. REG. L.J. 349, 355 (2013) (speculating that the Second Circuit's domestic transaction test will become the standard because of the court's renowned expertise in securities law).

8. 763 F.3d 198 (2d Cir. 2014) (per curiam).

9. *See id.* at 201, 205 (explaining that the securities-based swap agreement was a contract where plaintiffs and a third party agreed to exchange money depending on the price of Volkswagen shares, which were traded on foreign exchanges).

10. *Id.* at 201.

11. Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 476–77 (S.D.N.Y 2010), *aff'd sub nom. Parkcentral*, 763 F.3d 198.

12. *Parkcentral*, 763 F.3d at 214–16.

13. *See id.* at 215–16; *see also* Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1310 (11th Cir. 2011) (per curiam) (characterizing *Morrison* as adopting a bright-line test); Christopher Calfee, *Can't See the Forest for the Trees: Where Does a Purchase or Sale of Securities Occur?*, 2 AM. U. BUS. L. REV. 153, 154 (2012) (same); *Second Circuit Holds Transactions Domestic*, *supra* note 5, at 1430 (same).

14. *Parkcentral*, 763 F.3d at 216.

15. *See infra* Part I.B.2 (explaining that *Parkcentral* held courts could no longer solely rely on the transactional test to determine whether § 10(b) applied).

16. *See So Much for Bright-Line Tests on Extraterritorial Reach of U.S. Securities Laws?*, PROSKAUER (Aug. 18, 2014), http://www.proskauer.com/publications/client-alert/so-much-for-bright-line-tests-on-extraterritorial-reach-of-us-securities-laws (listing several "intriguing questions" raised by *Parkcentral*, including how much

importantly, the *Parkcentral* court did not clarify the specific test courts must use to determine when a case is sufficiently domestic to warrant § 10(b) liability.[17] The Second Circuit indicated courts would analyze a variety of factors but left it to future courts and cases to devise the specifics of the test.[18] Moreover, the court did not comment on how the economic reality method would fit into this analysis, if at all.

This Comment will argue that the economic reality method is still viable after *Parkcentral*, but that it now constitutes one of the factors of the sufficiency analysis rather than its previous use under the transactional test. This Comment proposes a framework for the new extraterritorial inquiry based on *Parkcentral*'s holding. Courts should now perform the *Morrison* transactional test and then analyze a variety of factors based on the totality of the circumstances to determine whether a case is sufficiently domestic to incur § 10(b) liability. One of these factors will be the economic reality of the security instrument.

Part I describes the development of the § 10(b) jurisprudence regarding extraterritoriality. This Comment begins by briefly explaining the creation of the Securities and Exchange Act of 1934 and the structure of § 10(b). Then, the Comment maps the development of the § 10(b) extraterritoriality case law. Part I ends by examining the recent developments under *Parkcentral*. Part II goes on to address the implications of *Parkcentral*'s holding. The Comment proposes a structure for the new sufficiency analysis and explains how it adheres to *Morrison*. This Comment argues this new structure is not an attempted return to the previously overruled conduct-and-effects test. Next, the Comment explains how the economic reality method is still viable post-*Parkcentral* and how the method should be used as part of the sufficiency analysis. Finally, this Comment argues that the proposed structure of this new test reconciles the previous issues under the strict transactional test.

I. BACKGROUND

A. An Overview of Section 10(b)'s Extraterritoriality Jurisprudence

Section 10(b) of the Exchange Act prohibits the use of manipulative or deceptive devices "in connection with the purchase

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leeway the court created to allow consideration of other factors in the transaction's nature to determine whether it is foreign or domestic).

17. *See Parkcentral*, 763 F.3d at 217 (noting that courts in future cases would need to examine the facts of each case to eventually develop a test).

18. *Id.*

or sale of any security."[19] The Exchange Act makes no reference in § 10(b) to whether the provision applies extraterritorially.[20] Courts originally decided on an ad hoc basis whether the statute applied to a particular case with foreign elements using a conduct-and-effects test.[21] Courts examined the level of fraudulent conduct in the United States and the effect the fraud had on U.S. investors.[22] The U.S. Supreme Court decidedly rejected this approach in *Morrison* and held that the Exchange Act did not apply extraterritorially.[23] *Morrison* required courts to apply the two-prong transaction test to determine whether a case has enough domestic elements to fall under § 10(b).[24] Since *Morrison*, the lower courts have refined the definition of each prong of the transactional test.[25] Section 10(b) jurisprudence shifted after the 2014 Second Circuit decision in *Parkcentral*, which held the transactional test was no longer sufficient to incur § 10(b) liability.

1. Section 10(b) of the Securities and Exchange Act of 1934

In the wake of the stock market crash of 1929, Congress passed the Securities and Exchange Act of 1934. The Exchange Act created the Securities and Exchange Commission, and along with the Securities Act of 1933 (Securities Act), established the foundations of modern federal securities regulation in the United States. Congress passed the Exchange Act to protect investors from fraudulent and manipulative practices and to ensure stability and confidence in the securities markets.[26] Section 10(b) of the Exchange Act is the most prominent anti-fraud provision. The provision makes it unlawful:

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19. Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012).

20. *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 264–65 (2010) (holding that the lack of affirmative indication from Congress that § 10(b) of the Exchange Act applies extraterritorially means that it does not).

21. Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1334 (2d Cir. 1972), *abrogated by Morrison*, 561 U.S. 247; Schoenbaum v. Firstbrook, 405 F.2d 200, 206, 209 (2d Cir. 1968), *abrogated by Morrison*, 561 U.S. 247.

22. *Morrison*, 561 U.S. at 256–58; *Leasco*, 468 F.2d at 1334; *Schoenbaum*, 405 F.2d at 206, 209.

23. *Morrison*, 561 U.S. at 264–65.

24. *Id.* at 267.

25. *See, e.g.*, City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 180 (2d Cir. 2014) (rejecting the "listing theory" for *Morrison*'s first prong); Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012) (concluding that parties must obtain irrevocable liability or transfer title in the United States to satisfy *Morrison*'s second prong); *In re* Vivendi Universal, S.A. Sec. Litig., 765 F. Supp. 2d 512, 531 (S.D.N.Y. 2011) (finding that cross-listed securities do not meet the first prong of *Morrison*).

26. *See generally* MARC I. STEINBERG, SECURITIES REGULATION 463 (6th ed. 2013) (providing a general overview of the Exchange Act and § 10(b)); *Second Circuit Holds*

> [t]o use or employ, in connection with the purchase or sale of any security . . . or any securities-based swap agreement[,] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.[27]

Though not specifically stated in the Act, courts have held that private litigants have an implied right of action under § 10(b).[28] Private plaintiffs must have been purchasers or sellers of the security and demonstrate such elements as materiality, scienter, reliance, and causation.[29] Defendants can be the other party to the security transaction or another entity that committed a fraud in connection with the security transaction.[30] Section 10(b) is a "catch-all" provision that Congress devised to cover a broad range of activity and securities.[31] Since the law's enactment, courts have refined and managed the parameters of § 10(b).

2. The conduct-and-effects test

For decades after Congress promulgated the Exchange Act, courts struggled to determine § 10(b) anti-fraud liability in cases with extraterritorial elements. Courts, led by the Second Circuit, eventually established the conduct-and-effects test in *Schoenbaum v.*

Transactions Domestic, *supra* note 5, at 1434 ("[T]he Exchange Act is at its core a remedial statute designed to protect investors and the integrity of U.S. securities markets, as well as to provide adequate deterrence and compensation for fraud . . . .").

27. Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 209 (2d Cir. 2014) (per curiam) (citing Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012)).

28. *See, e.g.*, Herman & MacLean v. Huddleston, 459 U.S. 375, 380 (1983) (noting that courts have consistently recognized a private right of action for § 10(b) for more than thirty-five years); Kardon v. Nat'l Gypsum Co., 69 F. Supp. 512, 513–14 (E.D. Pa. 1946) (holding that there was an implied private right of action for investors involved in a deceptive purchase of stock in a private company). *See generally* STEINBERG, *supra* note 26, at 463 (explaining that courts have acknowledged a private right of action despite no legislative history indicating Congress ever intended to create one).

29. *See In re* Int'l Bus. Machs. Corp. Sec. Litig., 163 F.3d 102, 106 (2d Cir. 1998) (reviewing de novo the plaintiff's claim that IBM violated § 10(b) by making false statements about its dividend); STEINBERG, *supra* note 26, at 463–65 (listing the full range of elements for a § 10(b) cause of action).

30. Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012); *see also Parkcentral*, 763 F.3d at 201 (plaintiffs sued the company whose stock was the basis for their swap agreement with another party); Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1309 (11th Cir. 2011) (per curiam) (plaintiffs sued defendants for fraudulently inducing them to purchase a boat).

31. STEINBERG, *supra* note 26, at 463.

Firstbrook[32] and *Leasco Data Processing Equipment Corp. v. Maxwell*.[33] The conduct-and-effects test remained the prevailing test in U.S. courts for over three decades.[34] In this two-prong test, courts examined whether the fraudulent conduct occurred in the United States and to what extent the fraud affected the United States and U.S. investors.[35] Although § 10(b) did not mention an extraterritorial scope, courts found that fraudulent conduct originating in the United States or having an effect on U.S. investors or securities markets created § 10(b) liability.[36] Circuit courts, however, were split as to whether the domestic conduct had to be material or merely significant to the fraud.[37]

In using the conduct-and-effects test, courts considered whether the Congress that passed the Act would have wanted § 10(b) to apply in the particular case.[38] This general approach is sometimes called imaginative reconstruction of legislative intent.[39] This method of inquiry led to wide unpredictability where determinative factors in one case would not be sufficient in another case.[40] Slowly, courts and commentators began to criticize the conduct-and-effects test.[41]

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32. 405 F.2d 200, 206, 209 (2d Cir. 1968) (using the effects portion of the test).

33. 468 F.2d 1326, 1334 (2d Cir. 1972) (using the conduct portion of the test), *abrogated by* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010).

34. *See Morrison*, 561 U.S. at 257–58 (remarking that the conduct-and-effects test became "the north star" of § 10(b) jurisprudence).

35. *See* Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 474 (S.D.N.Y. 2010) (noting that satisfaction of one prong was sufficient to incur § 10(b) liability), *aff'd sub nom. Parkcentral*, 763 F.3d 198.

36. *Morrison*, 561 U.S. at 257.

37. *See In re* Banco Santander Sec.-Optimal Litig., 732 F. Supp. 2d 1305, 1316–17 (S.D. Fla. 2010) (describing how the U.S. Courts of Appeals for the Second, Fifth, and Seventh Circuits held that the domestic conduct must be "material to the fraud's success," while the U.S. Courts of Appeals for the Third, Eighth, and Ninth Circuits only required the conduct to be significant), *aff'd sub nom.* Inversiones Mar Octava Limitada v. Banco Santander S.A., 439 F. App'x 840 (11th Cir. 2011) (per curiam).

38. *See Morrison*, 561 U.S. at 255–56 (describing the development of the conduct-and-effects test and the historical understanding that courts were left to discern the extraterritorial application of § 10(b)); *Leasco*, 468 F.2d at 1337 ("Still we must ask ourselves whether, if Congress had thought about the point, it would not have *wished* to protect an American investor . . . ." (emphasis added)), *abrogated by Morrison*, 561 U.S. 247.

39. *See generally* Caleb Nelson, *What is Textualism?*, 91 VA. L. REV. 347, 403–13 (2005) (differentiating and reconciling strict adherence to statutory text with the "imaginative reconstruction" approach, in which interpreters attempt to determine how the enacting legislators would have wanted the law to apply to a particular case).

40. *See Morrison*, 561 U.S. at 255–56, 258–59 (criticizing, for instance, how courts analyzed the conduct portion of the test differently depending on whether the investors were American or foreign).

41. *See id.* at 260–61 (describing the various criticisms of the conduct-and-effects test from courts and commentators).

3. The transactional test under Morrison v. National Australia Bank, Ltd.

The Supreme Court finally reviewed the conduct-and-effects test in 2010 with *Morrison*.[42] *Morrison* presented a "foreign-cubed claim" of foreign plaintiffs suing foreign and American defendants over the sale of the equivalent of shares of common stock on a foreign exchange.[43] National Australia Bank ("NAB") was the largest bank in Australia.[44] Its common stock traded on foreign exchanges, such as the Australia Stock Exchange Limited, but not on any American exchange.[45] In February 1998, NAB bought a mortgage servicing company, HomeSide Lending, Inc., in Florida.[46] Australian nationals brought a claim in the United States alleging that HomeSide "manipulated [its] financial models" to make its business seem more valuable than it actually was and that NAB was aware of the fraud.[47] The Southern District of New York, with the Second Circuit affirming, dismissed the claim using the conduct-and-effects test. The lower court stated that it lacked subject-matter jurisdiction to hear a case with such strong foreign elements.[48]

The Supreme Court, however, found as an initial matter that the lower courts did not accurately analyze the extraterritoriality of § 10(b).[49] Justice Scalia's majority opinion noted that courts apply a strong presumption against extraterritoriality when interpreting U.S.

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42. Though Congress attempted to overrule *Morrison* and reinstate the conduct-and-effect test in § 929(b) of the Dodd-Frank Act, most courts have found it to be ineffectual due to a drafting error. The provision states that "district courts . . . shall have jurisdiction over an action or proceeding brought or instituted by the [SEC]." SEC v. A Chi. Convention Ctr., LLC, 961 F. Supp. 2d 905, 911 (N.D. Ill. 2013) (citing 15 U.S.C. § 78aa (2012)). Therefore, on its face, § 929(b) addresses subject matter jurisdiction, and *Morrison* said extraterritoriality was a question on the merits and not on subject-matter jurisdiction. *Id.*; Arthur B. Laby, *Regulation of Global Financial Firms After* Morrison v. National Australia Bank, 87 ST. JOHN'S L. REV. 561, 584–85 (2013).

43. *Morrison*, 561 U.S. at 250–51, 283 n.11.

44. *Id.* at 251.

45. *Id.*

46. *Id.*

47. *Id.* at 252.

48. *Id.* at 253.

49. Notably, the Supreme Court found that the extraterritoriality inquiry was not a question of subject-matter jurisdiction but a merits question. Thus, the case should have been dismissed under Rule 12(b)(6) for failure to state a claim, not Rule 12(b)(1). However, because remedying this error would merely involve fixing the labels and would not change the end result, the Court continued with its analysis and did not remand. *See id.* at 253–54.

statutes;[50] in other words, parties must make a strong showing that Congress intended for them to apply extraterritorially.[51] However, Scalia clarified that the threshold was not so high as to require statutes to explicitly include an extraterritorial application provision.[52] Courts could also look at the surrounding context.[53] The Court found that § 10(b) of the Exchange Act did not meet this burden and thus did not apply extraterritoriality.[54]

To determine whether the transaction was sufficiently domestic to fall under the statute, the *Morrison* Court developed a new test based on the Exchange Act.[55] The Court crafted a transactional test, deciding that § 10(b) applies to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities."[56] The case at bar did not meet the transactional test because NAB shares were not sold on a domestic exchange and were not purchased or sold in the United States.[57] Thus, the Supreme Court affirmed the lower court's dismissal.[58]

4. History and previous use of the economic reality method

Courts had a relatively easy time delineating the transactional test's first prong ("transactions in securities listed on domestic exchanges").[59] However, there was less agreement on how to

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50. *Id.* at 255 (noting that, according to a "longstanding principle of American law," legislation from Congress will only apply within the territorial jurisdiction of the United States unless a contrary intent is made clear).

51. *Id.*

52. *Id.* at 265.

53. *Id.*

54. *Id.* Courts have gone on to find that the holdings of *Morrison* also apply to other sections of the Exchange Act and other U.S. securities laws. *See, e.g.*, Liu Meng-Lin v. Siemens AG, 763 F.3d 175, 183 (2d Cir. 2014) (whistleblower anti-retaliation provision of the Dodd-Frank Act); SEC v. Tourre, No. 10 Civ. 3229 (KBF), 2013 WL 2407172, at *7 (S.D.N.Y. June 4, 2013) (section 17(a) of the Securities Act); *In re* Smart Techs., Inc. S'Holder Litig., 295 F.R.D. 50, 55–57 (S.D.N.Y. 2013) (sections 11 and 12(a)(2) of the Securities Act); *In re* Vivendi Universal, S.A., Sec. Litig., 842 F. Supp. 2d 522, 527–29 (S.D.N.Y. 2012) (same).

55. *See Morrison*, 561 U.S. at 266–67 (noting that the Exchange Act centered on the purchase and sale of securities inside the United States and not on deception specifically).

56. *Id.*

57. *Id.* at 273.

58. *Id.*

59. *Id.* at 267. Although there were initial attempts to broadly read the first prong as including cross-listed securities, courts quickly dismissed those claims. *See* George T. Conway III, Morrison *at Four: A Survey of Its Impact on Securities Litigation*, *in* FEDERAL CASES FROM FOREIGN PLACES 8–9 (2014), http://www.instituteforlegalreform.com/

determine when a transaction was domestic under the second prong ("domestic transaction in other securities").[60] Courts predominantly used three methods to make this determination: the transfer of title method,[61] the irrevocable liability method,[62] and the economic reality method.[63] When examining complex security instruments, courts found the economic reality method as an especially useful analytical structure.[64] Courts in the past had used the economic reality method to determine whether a complex instrument fell under the statutory definition of a "security."[65] Under this test, courts emphasized a given transaction's substance and not the instrument's specific form.[66] The economic reality method allowed courts to adequately

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uploads/sites/1/federal-cases.pdf (remarking that, if plaintiffs had succeeded, they would have turned *Morrison* on its head). Case law has since settled that the first prong means "'listed and traded' on a domestic exchange." Grossmann, *supra* note 7, at 354.

60. Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 213 (2d Cir. 2014) (per curiam); *see* also Calfee, *supra* note 13, at 170 (noting how courts developed three different methods to determine whether a transaction was domestic under *Morrison*).

61. *See, e.g.*, Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1310–11 (11th Cir. 2011) (per curiam) (vacating the lower court's dismissal because the stocks closed in Miami and the title of shares was transferred to Quail when the stocks closed).

62. *See, e.g.*, Cascade Fund, LLP v. Absolute Capital Mgmt. Holdings Ltd., No. 08-cv-01381-MSK-CBS, 2011 WL 1211511, at *7 (D. Colo. Mar. 31, 2011) (dismissing the case because plaintiffs incurred irrevocable liability in the Cayman Islands and thus the transaction was not domestic); Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co., 753 F. Supp. 2d 166, 178 (S.D.N.Y. 2010) (reasoning that placing a buy order for the stock in the United States was not a domestic transaction because plaintiffs did not incur irrevocable liability at that point in the transaction).

63. *See, e.g.*, Valentini v. Citigroup, Inc., 837 F. Supp. 2d 304, 324 (S.D.N.Y. 2011) (using the economic reality method to determine that plaintiffs' convertible notes were in reality put options in domestic stocks); Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 476 (S.D.N.Y. 2010) (finding the securities-based swap agreements to be the economic equivalent of plaintiffs purchasing shares on a foreign exchange), *aff'd sub nom. Parkcentral*, 763 F.3d 198.

64. *See, e.g.*, *Valentini*, 837 F. Supp. 2d at 324 (convertible notes); *Elliott Assocs.*, 759 F. Supp. 2d at 476 (securities-based swap agreements); SEC v. Credit Bancorp, Ltd., 738 F. Supp. 2d 376, 396–97 (S.D.N.Y. 2010) (credit facility program).

65. *See, e.g.*, United Hous. Found., Inc. v. Forman, 421 U.S. 837, 858 (1975) (holding that a purchase into a housing cooperative did not constitute a security under U.S. securities laws); SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946) (declaring that the transaction in the case fell under the definition of an investment contract); Cont'l Mktg. Corp. v. SEC, 387 F.2d 466, 470 (10th Cir. 1967) (remarking that investors' purchase into a beaver breeding enterprise constituted a purchase of a security).

66. *See United Hous. Found.*, 421 U.S. at 848 (noting that the name of an instrument was not dispositive to the issue of whether it was a security as defined by U.S. securities law); STEINBERG, *supra* note 26, at 61 (explaining that courts relied on

deter fraud and protect investors by not allowing perpetrators to create new instruments outside a narrow definition of a security.[67] Courts using the economic reality method in relation to the extraterritorial test wanted to apply the same reasoning to determine whether securities transactions were domestic transactions.

5. The domestic transaction test under Absolute Activist Value Master Fund Ltd. v. Ficeto

Finally, in *Absolute Activist Value Master Fund Ltd. v. Ficeto*,[68] the Second Circuit settled on a test to determine whether a transaction was a "domestic transaction in other securities . . . ."[69] The court examined whether foreign hedge funds' purchases through a U.S. broker-dealer of securities issued by U.S. companies was a "domestic transaction" under *Morrison*.[70] Plaintiffs were Cayman Island hedge funds that hired Absolute Capital Management Holding Limited ("ACM") as their investment manager.[71] Plaintiffs alleged that defendants participated in a "pump-and-dump" scheme[72] where plaintiffs lost at least $195 million in U.S. penny stocks purchased

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the phrase "unless the context otherwise requires" in the Act when using the economic reality method).

67. *See* Reves v. Ernst & Young, 494 U.S. 56, 63 n.2 (1990) (inferring that Congress valued deterring fraud and protecting investors over clarity); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967) (remarking that the Exchange Act is "remedial legislation," and as such courts should interpret it broadly); *Elliott Assocs.*, 759 F. Supp. 2d at 475–76 (stating that the court must look at the economic reality of the swap to determine whether it "fall[s] within the ambit of federal securities regulations").

68. 677 F.3d 60 (2d Cir. 2012).

69. *See* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 201, 209, 213 (2d Cir. 2014) (per curiam). Other jurisdictions have also widely applied the Second Circuit's test. *See* Grossmann, *supra* note 7, at 355; *see, e.g.*, SEC v. Funinaga, No. 2:13-CV-1658 JCM (CWH), 2014 WL 4977334, at *7–8 (D. Nev. Oct. 3, 2014); SEC v. A Chi. Convention Ctr., LLC, 961 F. Supp. 2d 905, 917–18 (N.D. Ill. 2013) (finding that the SEC had sufficiently shown that irrevocable liability occurred domestically to survive a motion to dismiss).

70. *Absolute Activist*, 677 F.3d at 62.

71. *Id.*

72. Perpetrators of a pump-and-dump scheme artificially raise the price of a stock through false or exaggerated claims. Unsuspecting investors buy the stock, which helps further raise prices. The perpetrators will then sell off their stock at the exaggerated price while the victims will lose a significant portion of their investment as the stock price falls. *See* DAVID L. SCOTT, WALL STREET WORDS: AN A TO Z GUIDE TO INVESTMENT TERMS FOR TODAY'S INVESTOR 294 (3d ed. 2003); *Pump and Dump*, INVESTOPEDIA, http://www.investopedia.com/terms/p/pumpanddump.asp (last visited Dec. 1, 2015).

through PIPE[73] transactions.[74] After the *Morrison* decision was announced, the Southern District of New York dismissed *Absolute Activist* sua sponte, finding it lacked subject-matter jurisdiction.[75] On appeal, plaintiffs argued that their complaint satisfied the second prong of *Morrison*'s transactional test.[76]

The Second Circuit took this opportunity to elaborate on what constituted a "domestic transaction in other securities." First, the court examined the statutory and ordinary definitions of "purchase" and "sale."[77] A purchase or sale occurs when the purchaser and seller become obliged to complete the transaction, or, in other words, when the parties acquire irrevocable liability.[78] Additionally, a sale in its ordinary definition is considered "[t]he transfer of property or title for a price."[79] From these definitions, the court established the rule that domestic transactions under *Morrison* are transactions where the parties obtain irrevocable liability or transfer title in the United States.[80] The court further explained that irrevocable liability meant that "the purchaser incurred irrevocable liability within the United States to take and pay for a security, or that the seller incurred irrevocable liability within the United States to deliver a security."[81] The complaint did not "sufficiently allege that [the] purchases or sales took place in the United States," so the court remanded to allow the plaintiffs to amend their complaint.[82]

Absolute Activist's domestic transaction test, while still focusing on the location of the securities transaction, added an element of flexibility to the overall inquiry. The title transfer[83] and irrevocable

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73.Private investment in public equity (PIPE) transactions are transactions in which qualified investors, like private investment firms, purchase considerable shares in a public company at a discount. *See Private Investment in Public Equity—PIPE*, INVESTOPEDIA, http://www.investopedia.com/terms/p/pipe.asp (last visited Dec. 1, 2015).

74. *Absolute Activist*, 677 F.3d at 63.

75. *Id.* at 65.

76. *Id.* at 67.

77. *Id.*

78. *Id.* at 67–68.

79. *Id.* at 68 (citing *Sale*, BLACK'S LAW DICTIONARY (9th ed. 2009)).

80. *Id.* at 67.

81. *Id.* at 68.

82. *Id.* at 69–71.

83. *See, e.g.*, SEC v. Funinaga, No. 2:13-CV-1658 JCM (CWH), 2014 WL 4977334, at *8 (D. Nev. Oct. 3, 2014) (holding that defendants transferred title in the United States when they "transmitted application forms, money, and investment certificates to and from Las Vegas offices and bank accounts"); SEC v. Tourre, No. 10 Civ. 3229

liability[84] inquiries can depend on the nature of the security at issue. For instance, although typically wiring money to a bank in the United States is not enough factually to establish irrevocable liability, the court found it was enough in *Arco Capital Corps. v. Deutsche Bank AG.*[85] However, at its core, the domestic transaction test is still a location-based test.[86] In the digital world, the location of a security transaction has become "increasingly illusory . . . ."[87] While the irrevocable liability or transfer of title inquiries can rely heavily on the particularities of the specific contractual provisions, the location of the transaction may have little connection to the fraud.[88]

B. Recent Developments Under Parkcentral

The issues and potential inconsistencies of relying solely on a transactional test to determine the applicability of § 10(b) are highlighted in *Parkcentral*. Due to the distinctive nature of the security at issue, the case provided the court with a unique opportunity to critically examine *Morrison*'s transactional test. The security appeared to pass the transactional test even though the case seemed impermissibly foreign. The Second Circuit rectified this potential inconsistency in case law by determining that, although it was necessary for a case to pass *Morrison*'s transactional test for § 10(b) to apply, passing the *Morrison* test alone was not sufficient.[89]

(KBF), 2013 WL 2407172, at *3, *12 (S.D.N.Y. June 4, 2013) (concluding that the transfer of title occurred domestically based in part on the fact that the trade confirmations originated in New York).

84. *See, e.g.*, City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG, 752 F.3d 173, 181–82 (2d Cir. 2014) (deciding that the fact that the buy order was placed in the United States was not enough, on its own, to incur irrevocable liability); *Tourre*, 2013 WL 2407172, at *12–13 (concluding that ACA LLC incurred irrevocable liability when the master agreement and trade confirmations were signed in the United States).

85. *Compare Absolute Activist*, 677 F.3d at 70 (holding that investors wiring money to a bank in New York was not enough to make the transaction domestic), *and* MVP Asset Mgmt. (USA) LLC v. Vestbirk, No. 2:10-cv-02483-GEB-CKD, 2012 WL 2873371, at *7 (E.D. Cal. July 12, 2012) (same), *with* Arco Capital Corps. v. Deutsche Bank AG, 949 F. Supp. 2d 532, 542–43 (S.D.N.Y. 2013) (finding that the money sent to HSBC in New York was sufficient to impose irrevocable liability on the parties because the Note Subscription Agreements provided that the contract would be irrevocably binding when the money was delivered).

86. *Second Circuit Holds Transactions Domestic*, *supra* note 5, at 1437.

87. *Id.*

88. *Id.* at 1436–37.

89. Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 215–16 (2d Cir. 2014) (per curiam).

Thus, the court added a flexible element to the overall extraterritoriality inquiry while still adhering to *Morrison*.

1. The case in the Southern District of New York

Before *Absolute Activist*, the Southern District of New York heard another § 10(b) case called *Elliott Associates v. Porsche Automobil Holding SE*.[90] This case involved domestic and foreign plaintiffs[91] who had purchased from a third party securities-backed swap agreements that were tied to the price of Volkswagen AG ("Volkswagen") shares listed on a foreign exchange.[92] The plaintiffs took the equivalent of short positions[93] in Volkswagen shares, meaning they would profit if the shares declined in price.[94] However, Volkswagen share prices skyrocketed on the European Stock Exchange once Porsche Automobile Holding SE ("Porsche")[95] officially announced its intention to take over Volkswagen.[96] This resulted in a historic short squeeze where, "while some 12.8% of [Volkswagen] shares were on loan . . . those that for practical purposes were in circulation amounted to only 6%."[97] Plaintiffs alleged defendants made fraudulent statements and concealed Porsche's intention to take over Volkswagen.[98]

The court used the economic reality method to determine that the transaction was not a "domestic transaction[] in other securities"

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90. 759 F. Supp. 2d 469 (S.D.N.Y. 2010), *aff'd sub nom.*, *Parkcentral*, 763 F.3d 198.

91. *Id.* at 471 (both international and domestic hedge funds).

92. *Id.*; *see also Parkcentral*, 763 F.3d at 205 ("A securities-based swap agreement is a private contract between two parties in which they 'agree to exchange cash flows that depend on the price of a reference security, here [Volkswagen] shares.'" (citation omitted)).

93. "To take a short position in a stock, an investor borrows shares of the stock from a broker and sells them for the then-prevailing price. At some point in the future, the investor must purchase enough shares of the stock to replace the shares of stock borrowed from the broker. . . . [If] the purchase price is higher than the price at which the investor initially sold the security—*i.e.*, if the stock price has increased—the investor will take a loss, selling low and buying high." Joint Brief and Special Appendix for Plaintiffs-Appellants at 7, Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198 (2d Cir. 2014) (No. 11-0397) (citations omitted).

94. *Parkcentral*, 763 F.3d at 201; *Elliott Assocs.*, 759 F. Supp. 2d at 470, 471 n.2; *see also* Joint Brief and Special Appendix for Plaintiffs-Appellants, *supra* note 93, at 9 (explaining that "if party A is *long the swap*, and party B is *short the swap*, then party A will receive money from party B when the price of the stock rises, and party B will receive money from party A when the price of the stock falls").

95. Porsche is a German company. *Elliott Assocs.*, 759 F. Supp. 2d at 471.

96. *Parkcentral*, 763 F.3d at 205; *Elliott Assocs.*, 759 F. Supp. 2d at 470.

97. Joint Brief and Special Appendix for Plaintiffs-Appellants, *supra* note 93, at 15.

98. *Parkcentral*, 763 F.3d at 201; *Elliott Assocs.*, 759 F. Supp. 2d at 470.

under the transactional test.[99] Although the parties conducted the swap agreements in the United States, the court held that the transaction's economic reality was more akin to domestic plaintiffs buying foreign shares of a foreign company on a foreign exchange.[100] Applying § 10(b) to these securities would not be true to *Morrison*'s intent to maintain a strong presumption against extraterritoriality because the case's major elements were foreign despite the fact that the swap agreements were physically conducted in the United States.[101] The court dismissed the case, and the plaintiffs appealed.[102]

2. The case in the Second Circuit

The Second Circuit did not fully perform *Morrison*'s transactional test,[103] affirming the dismissal on other grounds.[104] Instead, the court determined that, although a domestic transaction (or a transaction in a domestically listed security) was necessary for a court to find § 10(b) liability, passing *Morrison*'s transactional test was not sufficient for § 10(b) to apply.[105] In some cases, courts would have to analyze a variety of other factors to determine whether the transaction was sufficiently domestic for § 10(b) to apply.[106]

The court noted that *Morrison* concerned conventional purchases of stocks, while this case differed because it concerned securities-based swap agreements.[107] Plaintiffs' securities-based swap agreements may have referenced Volkswagen shares, but neither party to the swap ever actually owned the shares.[108] The swaps were distinct from the referenced security.[109] The court admitted its holding depended in part on the unique nature of the security

99. *Elliott Assocs.*, 759 F. Supp. 2d at 475–76.
100. *Id.* at 474, 476.
101. *Parkcentral*, 763 F.3d at 201–02; *Elliott Assocs.*, 759 F. Supp. 2d at 476; *see also* Morrison v. Nat'l Austl. Bank, Ltd., 561 U.S. 247, 266 (2010) (noting that the presumption was a strong enough "watchdog" that it would not retreat at the first sign of any domestic activity).
102. *Elliott Assocs.*, 759 F. Supp. 2d at 476–77.
103. *See id.* at 216 (stating that the facts of the case were so "predominately foreign as to be impermissibly extraterritorial").
104. *Parkcentral*, 763 F.3d at 201.
105. *Id.* at 215–16.
106. *See id.* at 217 (calling for courts to use a fact-specific analysis to determine whether a case is sufficiently domestic for § 10(b) to apply).
107. *Id.* at 214.
108. *Id.* at 206.
109. *Id.*

involved but also declined to determine whether it would have come to the same conclusion if a different type of security were involved.[110]

The court gave two main reasons for why passing the transactional test is insufficient to determine whether a transaction is sufficiently domestic for § 10(b) liability.[111] First, the court noted that the specific language used by the Supreme Court did not say it was sufficient.[112] In *Morrison*, the Supreme Court stated that § 10(b) applies only to "transactions in securities listed on domestic exchanges[] and domestic transactions in other securities . . . ."[113] The Court did not say "§ 10(b) will be deemed domestic whenever such a transaction is present."[114] The Supreme Court used language delineating that transaction location was a necessary element to make § 10(b) applicable but did not say it was dispositive.[115] Second, the Second Circuit argued that a bright-line rule would undermine *Morrison*'s insistence that § 10(b) did not apply extraterritorially.[116] Litigants can bring § 10(b) cases against any entity that committed a fraud in connection with the security transaction; the entity does not necessarily have to be a participant in the security transaction.[117] Therefore, cases could concern a domestic transaction but still include impermissibly foreign facts.[118]

Examining a variety of factors,[119] the court determined that the facts of *Parkcentral* were too foreign to comport with the underlying principles of *Morrison*.[120] The case concerned an alleged fraud by foreign defendants that occurred in a foreign country regarding

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110. *Id.* at 202.
111. *Id.* at 215.
112. *Id.*
113. *Id.* (citing Morrison v. Nat'l Austl. Bank, Ltd., 561 U.S. 247, 267 (2010)).
114. *Id.*
115. *See id.*
116. *Id.*
117. *See* Securities and Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012); *see, e.g.*, *Parkcentral*, 763 F.3d at 219 (Leval, J., concurring) (noting that plaintiffs sued the company whose stock was the basis for their swap agreement with another party).
118. *Parkcentral*, 763 F.3d at 215.
119. The determination was particular to the facts of this case: (a) involving statements of a German company, (b) mostly made in Germany, (c) about another German company, (d) which is traded on only foreign exchanges, (e) where the defendants did not participate in the plaintiffs' swap agreements, (f) where plaintiffs had no actual ownership in that stock (though the swap agreements reference the German stock), (g) where German authorities investigated these statements, and (h) where the case was in front of German courts. *Id.* at 216; *id.* at 218 (Leval, J., concurring).
120. *Id.* at 216.

foreign securities traded on a foreign exchange.[121] Although plaintiffs and other third parties allegedly entered into the swap agreements in the United States, the foreign defendants were not in any way involved in these transactions.[122] Therefore, the Second Circuit affirmed the dismissal of the complaints.

Parkcentral will have a major impact on future securities fraud cases, but the Second Circuit still left open some issues going forward.[123] The court did not give any specific test for courts to use in the future to determine when a case is sufficiently domestic to warrant § 10(b) liability.[124] Moreover, the court did not comment on how the economic reality method would fit into this analysis, if at all.

II. THE ADDITION OF THE SUFFICIENCY PRONG TO THE EXTRATERRITORIAL TEST WILL HELP COURTS ADHERE TO *MORRISON*

This Part advocates for a new structure of the extraterritoriality inquiry based on *Parkcentral*'s holding. Courts should first perform the *Morrison* transactional test as a threshold matter, then address whether the transaction meets *Parkcentral*'s sufficiency test. The sufficiency test will be a factor-based test, requiring courts to look at the totality of the circumstances.[125] The new structure of the test adheres to the principles set forth in *Morrison* and is not an attempt by the Second Circuit to return to the overruled conduct-and-effects test.

Next, the economic reality method is still viable after *Parkcentral*. Courts, however, should not use the economic reality method as part of *Morrison*'s transactional test as the district court did in its decision.[126] Instead, courts should use the economic reality method as one of the factors of the sufficiency test. The inclusion of the economic reality method in the extraterritorial framework will allow courts to more effectively apply *Morrison* to a variety of security instruments.

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121. *Id.* at 216.

122. *Id.* at 207.

123. *See So Much for Bright-Line Tests on Extraterritorial Reach of U.S. Securities Laws?*, *supra* note 16 (listing several "intriguing questions" raised by *Parkcentral*).

124. *Parkcentral*, 763 F.3d at 217.

125. *See id.* (calling on future courts to determine whether a case is sufficiently domestic by carefully analyzing the facts specific to each case); *id.* at 218 (Leval, J., concurring) (listing some of the specific factors the court used to come to its decision in *Parkcentral*).

126. *See* Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 476 (S.D.N.Y. 2010) (finding the securities-based swap agreement was not a domestic transaction because in economic reality the swaps were more akin to plaintiffs purchasing stocks on a foreign exchange), *aff'd sub nom. Parkcentral*, 763 F.3d 198.

Furthermore, the new two-step extraterritoriality test will help courts maintain *Morrison*'s strong presumption against extraterritoriality. Although the *Morrison* Court fashioned the transactional test to preserve this presumption, the test's singular focus on transaction location can result in rulings that are at odds with the presumption in some instances. The test advocated below will strengthen *Morrison*'s presumption against extraterritoriality by providing courts with more tools to evaluate cases with foreign elements. Courts can address international comity concerns through the economic reality method and the totality of the circumstances framework. Additionally, the new extraterritorial test strengthens the presumption by establishing a balance between flexible and bright-line rules.

A. The New Extraterritorial Test Should Be Morrison*'s Transactional Test Followed by* Parkcentral*'s Sufficiency Test*

In *Parkcentral*, the Second Circuit did not state any specific test it used to determine that the facts were not sufficient to invoke § 10(b).[127] The court left it to future courts "eventually to develop a reasonable and consistent governing body of law" based upon a fact-specific analysis of the particular case at hand.[128] Courts should now first conduct the transactional test as a threshold matter, and then apply the sufficiency test using a totality of the circumstances analysis of a variety of factors. The addition of a sufficiency test will provide both flexibility and consistency to the overall extraterritorial framework.

1. The sufficiency test will be a factor-based test

Courts will first perform *Morrison*'s transactional test.[129] Initially, courts must determine whether the case involves a security "listed on domestic exchange[]" or a "domestic transaction[] in other securities . . . ."[130] For the first prong of the transactional test, a court will examine whether the security at issue is "listed and traded on a domestic exchange."[131] For the second prong, courts will use the

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127. *Parkcentral*, 763 F.3d at 217.

128. *Id.*

129. *See* Morrison v. Nat'l Austl. Bank, Ltd., 561 U.S. 247, 267 (2010) (describing its two-prong transactional test); *supra* Part I.A.4–5 (detailing how further definitions for both prongs were settled by subsequent cases).

130. *Morrison*, 561 U.S. at 267.

131. *See* Grossmann, *supra* note 7, at 354 (describing how courts rejected the cross-listing theory that § 10(b) claims with foreign exchange transactions are permissible "as long as securities of the same class were also listed on a U.S. exchange, either as a

Absolute Activist test to determine whether the parties incurred irrevocable liability or transferred title in the United States.[132] If the case does not pass either of these tests, then the court can dismiss the case for failure to state a claim under Rule 12(b)(6).[133] If the case does pass the transactional test, then the court can move on to the second step of the extraterritorial test.

Based on *Parkcentral*'s holding, courts will now also have to determine whether a case is sufficiently domestic to warrant § 10(b) liability. Under the sufficiency test, the court will look at a variety of other factors and, based on the totality of the circumstances, determine whether § 10(b) applies. Although this Comment focuses on only one of these factors,[134] it is apparent that courts will use other factors, such as whether there is a concurrent investigation in another country[135] and the nature of the defendant's connection to the security at issue.[136]

The new extraterritorial framework of the transactional test and sufficiency test is consistent with the Exchange Act and *Morrison* for two important reasons. First, the sufficiency test correctly takes into consideration the purpose and intent underlying the Exchange Act. Congress passed the Exchange Act to protect investors and ensure the integrity of U.S. securities markets.[137] Strict adherence to a bright-line rule that only analyzes transaction location can erode confidence in the U.S. securities markets and facilitate fraudulent schemes. Bright-line rules help give potential securities law violators a roadmap of how to remain

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dual listing or as a cross-listing in the form of American Depository Receipts" (footnote omitted)).

132. Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012).

133. *See Morrison*, 561 U.S. at 254 (noting that the extraterritorial analysis was a merits question; thus, dismissal of these cases would be under Rule 12(b)(6) and not Rule 12(b)(1)).

134. *See infra* Part II.B (describing the economic reality method).

135. *See* Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 218 (2d Cir. 2014) (Leval, J., concurring) (per curiam) (explaining that one of the factors the court used in its decision that *Parkcentral* was not sufficiently domestic was that the German authorities already investigated the fraud, and the issue is currently in front of German courts).

136. *See id.* at 218 (considering the fact that defendants were not a part of, nor were aware of, plaintiffs' securities-based swap agreements).

137. *See* STEINBERG, *supra* note 26, at 463 (providing a general overview of the Exchange Act and § 10(b)); *Second Circuit Holds Transactions Domestic*, *supra* note 5, at 1434 ("[T]he Exchange Act is at its core a remedial statute designed to protect investors and the integrity of the U.S. securities markets, as well as to provide adequate deterrence and compensation for fraud.").

outside U.S. jurisdiction.[138] The new extraterritorial test addresses this concern by adding a second flexible step into the analysis. In this second step, plaintiffs would have to demonstrate, based on a variety of other factors,[139] that the case is sufficiently domestic. Therefore, potential securities law violators could not so determinatively structure their scheme to remain outside § 10(b)'s scope.

Second, the addition of the sufficiency test fits into the development of the extraterritoriality jurisprudence.[140] Courts tried to keep the extraterritoriality inquiry very flexible with the conduct-and-effects test.[141] In practice, however, the conduct-and-effect test was too unpredictable. The Supreme Court in *Morrison* instituted a bright-line proclamation that § 10(b) did not apply extraterritorially, and courts should use a two-prong transactional test to determine whether cases were sufficiently domestic.[142] Then, the Second Circuit in *Absolute Activist* added some flexibility to the transactional test under the domestic transaction prong.[143] Irrevocable liability and transfer of title can, to an extent, be context-specific to the type of security.[144] Nonetheless, the flexibility under the transactional test was limited because the inquiry was still based on the transaction location.[145] Commentators noted that, in securities cases where the transaction location was more "happenstance," application of only the transactional test could lead to results that diametrically opposed *Morrison*.[146] The sufficiency analysis completes this trend by foreclosing a major loophole that potential fraudsters could still use.

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138. *See Morrison*, 561 U.S. at 285 (Stevens, J., concurring) (providing the hypothetical of executives of a subsidiary company located in the United States fraudulently inducing American investors to buy shares in the parent corporation, which was only listed on a foreign exchange); *Parkcentral*, 763 F.3d at 218 (Leval, J., concurring) (arguing that *Morrison* did not intend to create a bright-line rule).

139. Courts could use such factors as economic reality, whether there is a concurrent investigation in another country, or defendants' connection to the security at issue. *See supra* Part II.A.1.

140. *See supra* Part I.

141. *See supra* Part I.A.2.

142. *See supra* Part.I.A.3.

143. *See supra* Part I.A.5.

144. *See Second Circuit Holds Transactions Domestic*, *supra* note 5, at 1433, 1435 & n.48 (construing *Absolute Activist* as adding some flexibility to *Morrison*'s transactional test because of the fact-intensive nature of the examination under irrevocable liability and transfer of title).

145. *See id.* at 1436–37 (noting that the flexibility of the *Absolute Activist* test is still limited because the test is still under the scope of determining only transaction location).

146. *See, e.g.*, John Chambers, Note, *Extraterritorial Private Rights of Action: Redefining the Transactional Test in* Morrison v. National Australia Bank, 31 REV. BANKING

2. The sufficiency analysis is not a return to the conduct-and-effects test

At a superficial glance, the language of the Second Circuit in *Parkcentral* could seem reminiscent of the previously overturned conduct-and-effects test.[147] The court in its inquiry focused on the particular facts of the case.[148] Many of these facts align with the main issue that Porsche's allegedly fraudulent conduct took place primarily on foreign soil.[149] The Second Circuit did not proffer a specific test with exact elements, but called on future courts to analyze carefully the facts specific to their cases to make the sufficiency determination.[150] The *Morrison* Court lambasted the conduct-and-effects test, which evaluated the particular circumstances of each case, as leading to widely unpredictable results.[151] For example, *Morrison* criticized how courts under the conduct-and-effects test would analyze the conduct portion of the test differently depending on whether the investors were domestic or foreign.[152]

However, the sufficiency test is not a return to the conduct-and-effects test because the flexible, factor-based test of *Parkcentral* will be a test separate from the transactional test of *Morrison*. As explained in Judge Leval's concurrence, *Morrison*'s criticisms of the conduct-and-effects test were related to how such concerns should not have been under the extraterritoriality analysis.[153] Conversely, the sufficiency test maintains the presumption against extraterritoriality of *Morrison*. The sufficiency test is not a return to the conduct-and-effects test

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& FIN. L. 411, 427, 435 (2011) (remarking that courts will struggle with determining the location of swap transactions for purposes of applying the *Morrison* test); *Second Circuit Holds Transactions Domestic*, *supra* note 5, at 1436 (finding this trend in the case of securities-based swap agreements, over-the-counter securities, and American Depository Receipts).

147. *See* Alisha Patterson, Case Comment, Parkcentral Global Hub Ltd v. Porsche Auto. Holdings SE, 763 F.3d 198 (2d Cir. 2014), 38 SUFFOLK TRANSNAT'L L. REV. 233, 250 (2015) (misconstruing *Parkcentral*'s analysis as inappropriately similar to the conduct test); *So Much for Bright-Line Tests*, *supra* note 16 (declaring that the Second Circuit "got its revenge" on the Supreme Court with *Parkcentral*).

148. *See* Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 218 (2d Cir. 2014) (Leval, J., concurring) (per curiam) (listing the various facts considered by the court in its decision).

149. *Id.*

150. *Id.* at 217.

151. Morrison v. Nat'l Austl. Bank, Ltd., 561 U.S. 247, 261 (2010).

152. *Id.* at 255–56, 258–59.

153. *Parkcentral*, 763 F.3d at 219 (Leval, J., concurring); *see also* Conway, *supra* note 59, at 4, 16 ("For the point of *Morrison* was not to adopt a 'bright-line rule[]' for the sake of having a bright-line rule, but rather to . . . fashion a 'test that will avoid' the 'interference with foreign . . . regulation that application of [U.S. law] would produce.'" (footnote omitted)).

because it is positioned in a different place in the inquiry.[154] The sufficiency test is part of the analysis to determine whether a transaction is sufficiently domestic to warrant § 10(b) liability.[155] Moreover, cases must still pass *Morrison*'s transactional test for § 10(b) to apply.[156] The sufficiency test also recognizes that, in today's highly complex and international financial markets, a bright-line rule would not always be the best way for courts to maintain that presumption.[157]

After *Parkcentral*, courts should now use a two-step extraterritorial test, which combines *Morrison*'s transactional test with a new sufficiency test. In the new sufficiency portion of the test, courts will evaluate a variety of factors and, based on the totality of the circumstances, decide whether the case is sufficiently domestic to warrant the application of § 10(b). The new extraterritorial framework is consistent with the Exchange Act and *Morrison*. The new test helps protect investors and ensure the integrity of the U.S. securities market by combining bright-line and flexible tests to deter potential securities law violators from developing schemes outside § 10(b)'s scope. Additionally, the sufficiency test fits into the development of the extraterritorial jurisprudence. The new framework is not a return to the conduct-and-effects test because it does not decide whether a case applies extraterritorially but incorporates a flexible analysis to strengthen the presumption against extraterritoriality.

B. The Economic Reality Method Will Be Part of the New Extraterritorial Test

The economic reality method is still viable after the Second Circuit's decision in *Parkcentral*; the Second Circuit did not specifically overrule the district court's method. However, the *Elliott Associates* court erred in using the economic reality method as part of the transactional test.[158] Courts should instead use the economic reality method as one of the factors in the sufficiency test.

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154. *See Parkcentral*, 763 F.3d at 218–19 (Leval, J., concurring) (explaining that the conduct-and-effects test was criticized by the Supreme Court because it improperly "'disregard[ed]' the presumption against extraterritoriality" (alteration in original) (quoting *Morrison*, 561 U.S. at 255)).

155. *But cf.* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1337 (2d Cir. 1972) (asking whether Congress would have wanted § 10(b) to apply to such a case with foreign elements), *abrogated by Morrison*, 561 U.S. 247.

156. *See Parkcentral*, 763 F.3d at 215–16 (holding that § 10(b) applied only to cases that passed *Morrison*'s transactional test).

157. *Id.* at 219 (Leval, J., concurring).

158. *See* Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 476–77 (S.D.N.Y. 2010), *aff'd sub nom. Parkcentral*, 763 F.3d 198.

*1. The economic reality method is still viable post-*Parkcentral

Although the Second Circuit did not comment on the district court's reliance on the economic reality method, the method is still viable in determining § 10(b) liability. Courts have long used economic reality to determine whether unique security instruments, like derivatives, fall under the securities laws.[159] In this jurisprudence, courts emphasized the economic reality of the transaction over the specific form of the instrument.[160] Courts now in the extraterritorial framework are likewise faced with determining whether cases with complex securities are covered by § 10(b) liability. The economic reality method provides a solid framework for courts to evaluate how unique securities fit into § 10(b). Courts use the economic reality method, keeping in mind the purposes of the Securities Act and the Exchange Act: to maintain integrity in the market and protect investors.[161] The economic reality method allowed courts to adequately deter fraud and protect investors by not allowing perpetrators to create new instruments outside a narrow definition of a security.[162] Similarly, in the extraterritorial framework, courts have struggled with implementing a clear test that also ensures that perpetrators cannot easily create new security instruments outside the scope of § 10(b). Using the economic reality method as one of the factors in the sufficiency test provides a solid foundation for courts to look

159. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 848–49 (1975); *Elliott Assocs.*, 759 F. Supp. 2d at 475.

160. *See United Hous. Found.*, 421 U.S. at 848 (noting that the name of an instrument was not dispositive in determining whether it was a security as defined by U.S. securities laws); STEINBERG, *supra* note 26, at 61 (explaining that courts relied on the phrase "unless the context otherwise requires" in the Act when using the economic reality method).

161. *See United Hous. Found.*, 421 U.S. at 849 (referencing the "primary purpose" of both Acts in using the economic reality method); STEINBERG, *supra* note 26, at 463 (providing a general overview of the Exchange Act and § 10(b)); *Second Circuit Holds Transactions Domestic*, *supra* note 5, at 1434 ("[T]he Exchange Act is at its core a remedial statute designed to protect investors and the integrity of the U.S. securities markets, as well as to provide adequate deterrence . . . .").

162. *See* Reves v. Ernst & Young, 494 U.S. 56, 63 n.2 (1990) (inferring that Congress valued deterring fraud and protecting investors over clarity); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967) (remarking that courts should broadly interpret remedial legislation like the Exchange Act); *Elliott Assocs.*, 759 F. Supp. 2d at 475–76 (stating that the court must look at the economic reality of the swap to determine whether it "fall[s] within the ambit of federal securities regulations").

towards the substance of how security transactions affect U.S. and foreign markets and not focus solely on the specific form of the security.[163]

For example, in *Parkcentral*, the plaintiffs had both short sales and private securities-based swaps.[164] The short sales and the securities-based swap agreements economically created the same effect.[165] Originally, the plaintiffs based their § 10(b) claim solely on the short sales.[166] After *Morrison*, however, the plaintiffs had to switch their claims to be based solely on the swaps because the short sales were foreign securities transactions.[167] Accepting the plaintiffs' contention that the swap agreements were conducted in the United States, applying only the transactional test would result in short sales not being covered by § 10(b), but the swap agreements would be covered.[168] By focusing only on the form of the security transaction and not also the substance, courts would not be accurately applying *Morrison*. As the defendants noted in *Parkcentral*: "There is no basis for [courts] to adopt a rule that would favor sophisticated investors who enter into private swap agreements over ordinary investors who trade directly in the same foreign-traded securities."[169] Both securities transactions are impermissibly foreign and, according to

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163. *See United Hous. Found.*, 421 U.S. at 848 (noting that courts must look past the actual name of the instrument and examine how the instrument functioned to determine whether it was a security); STEINBERG, *supra* note 26, at 61 (explaining courts relied on the phrase "unless the context otherwise requires" in the Act when using the economic reality method).

164. Brief of Defendant-Appellee Porsche Automobil Holding SE at 3, Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198 (2d Cir. 2014) (No. 11-0397).

165. *See supra* notes 93–95 and accompanying text.

166. Brief of Defendant-Appellee Porsche Automobil Holding SE, *supra* note 164, at 3.

167. *Id.*; *see* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 265 (2010) (holding that § 10(b) of the Exchange Act does not apply extraterritorially).

168. *See* Brief of Defendant-Appellee Porsche Automobil Holding SE, *supra* note 164, at 29 ("[I]t would not . . . be an acceptable outcome for an individual who had benefitted from insider information and who would be legally prohibited from buying a stock . . . to be able to engage in a total return swap that was the functional equivalent of buying that stock." (quoting *The Commodity Futures Modernization Act of 2000: Joint Hearing on S. 2697 Before the S. Comm. on Agric., Nutrition, and Forestry and the S. Comm. on Banking, Hous., and Urban Affairs*, 106th Cong. 14 (2000) (statement of Lawrence Summers, Sec'y of the U.S. Dep't of the Treasury))); Letter from Robert J. Guiffra, Jr., Counsel for Appellees, to Catherine O'Hagan Wolfe, Clerk of the Court 1–2 (May 12, 2014), Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198 (2d Cir. 2014) (No. 11-0397).

169. Brief of Defendant-Appellee Porsche Automobil Holding SE, *supra* note 164, at 5.

Morrison's presumption against extraterritoriality, neither transaction should incur § 10(b) liability.[170]

2. Economic reality will be one of the factors in the sufficiency analysis

Although the district court in *Elliott Associates* came to the right conclusion, the court erred in using the economic reality method as part of the transactional test.[171] After *Absolute Activist*, using the economic reality method to determine transaction location is inappropriate.[172] The economic reality method should instead be one of the factors under the sufficiency analysis.

As described in Part II.A.1, the sufficiency test will occur after *Morrison*'s transactional test. The sufficiency test uses a variety of factors to determine whether a transaction is sufficiently domestic for § 10(b) to apply.[173] Courts will apply a totality of the circumstances analysis where no one factor is required or more important than the others.[174] This Comment contends that the economic reality method should be one of those factors. Although a given case might pass the transactional test, courts should still look past the form of the security and inquire how the security functioned in its economic reality.[175]

The placement of the economic reality method in the sufficiency test would be ideal for several important reasons. First, the extraterritorial test would better correspond with *Morrison* by having the economic reality method as a factor in the sufficiency test as opposed to using it under the transactional test. The district court in *Elliott Associates* used the economic reality method in the transactional test, and it created some potential inconsistencies. The district court

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170. *See Morrison*, 561 U.S. at 265–66 (stating that just because a case has some domestic elements, it does not mean that § 10(b) automatically applies as it is rare for a case to have no domestic elements).

171. *See* Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 476–77 (S.D.N.Y. 2010), *aff'd sub nom.* Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198 (2d Cir. 2014) (per curiam).

172. *See* Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67 (2d Cir. 2012).

173. *See supra* Part II.A.1.

174. Though this Comment focuses on only one factor of the sufficiency test, it is conceivable that courts will use other factors, such as the extent of a defendant's connection to the security at issue and whether a concurrent investigation in another country has commenced.

175. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 858–59 (1975) (determining that the "stock" involved in the case was not a security because plaintiffs were functionally renting an apartment for their own use); SEC v. W.J. Howey Co., 328 U.S. 293, 298–300 (1946) (finding that the transactions at issue were investment contracts because in reality the investors were not citrus farmers and, therefore, were relying on the efforts of third parties for their profit).

held that the plaintiffs' securities-based swap agreements were the economic equivalent of purchasing shares on a foreign exchange.[176] Therefore, § 10(b) liability could not apply to the case.[177] However, following that line of reasoning, foreign parties could create a securities-based swap agreement, but as long as the underlying security was a U.S. stock, § 10(b) liability would apply.[178] This result does not comport with the underlying principles of *Morrison*, such as the strong presumption against extraterritoriality.[179] The hypothetical case would still have strong foreign elements, and it would be inappropriate for courts to attach § 10(b) liability to such a case.[180]

However, placing the economic reality method under the sufficiency portion of the test and not the transactional test helps to apply *Morrison* appropriately. If the foreign parties conducted the swap abroad, the case would not pass the transactional test and the court would complete its inquiry.[181] If the foreign parties created the swap domestically, then the court could turn to the various factors of the sufficiency test. The court would look at the economic reality of the transaction and find it was similar to plaintiffs purchasing a U.S. stock on a domestic exchange. Nevertheless, the court would still need to look at the totality of the circumstances. The economic reality method would point towards the application of § 10(b), yet there might be other stronger factors that convince the court the transaction is too foreign.[182]

Second, economic reality would be only one of the factors that courts would use to determine sufficiency.[183] Therefore, in cases

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176. *Elliott Assocs.*, 759 F. Supp. 2d at 476.

177. *Id.* at 476–77.

178. *See* Chambers, *supra* note 146, at 427–28 (remarking that the court in *Elliott Associates* reached the correct outcome but with faulty reasoning); *see also* Richard W. Painter, Comment Letter on Release No. 34-63174; File No. 4-617, Study on Extraterritorial Private Rights of Action 6 (Feb. 17, 2011), http://www.sec.gov/comments/4-617/4617-7.pdf (reasoning that Congress, with the Dodd-Frank Act, should have addressed when swap agreements occur within the United States instead of having courts decipher when they occur).

179. *See* Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 265 (2010) (holding that § 10(b) of the Exchange Act does not apply extraterritorially).

180. *See id.* at 265–66 (noting that the presumption was a strong enough "watchdog" such that it would not retreat at the first sign of any domestic activity).

181. *See id.* at 267 (finding that "securities listed on domestic exchanges and domestic transactions in other securities" are the only transactions that fall under § 10(b) jurisdiction).

182. *See* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 217 (2d Cir. 2014) (per curiam) (remarking that courts should conduct a fact-specific analysis when applying the sufficiency test).

183. *See supra* notes 135–36 and accompanying text.

where the instrument is simple, courts would not need to use the economic reality method. The focus of the extraterritorial framework would still be on the transaction as directed by *Morrison*, but that would not be final.[184] In cases with more complicated securities instruments, the court could use the economic reality method to determine whether in reality the transaction location should be sufficient to determine § 10(b) liability.

The economic reality method is still viable after *Parkcentral*. However, the economic reality method should not be used to determine transaction location.[185] This Comment argues courts should use the economic reality method as one of the factors in the sufficiency test. By placing the economic reality method in the sufficiency test, courts would better be able to appropriately apply *Morrison* to a wide range of security instruments and fact patterns.

C. The New Two-Step Extraterritorial Test Strengthens Morrison*'s Presumption Against Extraterritoriality*

The new two-step extraterritorial test will help courts to maintain *Morrison*'s strong presumption against extraterritoriality. Under the extraterritorial analysis, cases will rarely have all foreign elements and no connection to the United States.[186] More often, cases will have a mixture of foreign and domestic elements, and courts must evaluate those elements to determine whether the transaction is sufficiently domestic to fall under § 10(b).[187] Although the Supreme Court in *Morrison* developed the transactional test to facilitate this inquiry, the test's singular focus on transaction location can actually hinder the preservation of the presumption against extraterritoriality in some instances. The two-step extraterritorial test will strengthen *Morrison*'s presumption against extraterritoriality by addressing more fully

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184. *See Morrison*, 561 U.S. at 266, 272 (arguing that the focus of the Exchange Act is not fraud generally, but only fraud in connection with the purchase or sale of a security in the United States).

185. *Compare* Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 475–76 (S.D.N.Y 2010) (using the economic reality method to determine whether the security transaction in the case was a domestic transaction under *Morrison*), *aff'd sub nom. Parkcentral*, 763 F.3d 198, *with* Absolute Activist Value Master Fund Ltd. v. Ficeto, 677 F.3d 60, 67–68 (2d Cir. 2012) (defining domestic transactions as transactions where the parties obtain irrevocable liability or transfer title in the United States).

186. *See Morrison*, 561 U.S. at 266 (clarifying that the presumption against extraterritoriality often is not "self-evidently dispositive").

187. *See id.* ("[T]he presumption against extraterritorial application would be a craven watchdog indeed if it retreated to its kennel whenever *some* domestic activity is involved in the case.").

international comity concerns and establishing the proper balance between flexible and bright-line rules.

1. The new two-step extraterritorial test will satisfy international comity concerns

A common concern among courts addressing questions of extraterritoriality is how to adequately address international comity concerns.[188] The Supreme Court noted such an apprehension in its analysis of the extraterritoriality of § 10(b) of the Exchange Act in *Morrison*.[189] For instance, in its holding the Court, in part, considered how there could be major conflicts with other countries' regulations if § 10(b) did apply abroad.[190] However, in the Exchange Act, Congress made no reference as to how courts could address any conflicts with foreign laws.[191] Therefore, Congress did not intend § 10(b) to apply extraterritorially.[192]

Though *Morrison* helped alleviate some of the international comity concerns, courts still struggled.[193] Courts were using the transactional test to determine whether transactions were sufficiently domestic for § 10(b) liability to apply; however, the singular focus of the transactional test was ill-suited to adequately address more complicated security instruments.[194] The new two-step extraterritorial test would help

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188. *See* Hilton v. Guyot, 159 U.S. 113, 163–64 (1895) (recognizing that international comity concerns "having due regard both to international duty and convenience[] and to the rights of its own citizens"); Joel R. Paul, *The Transformation of International Comity*, LAW & CONTEMP. PROBS., Summer 2008, at 19, 21 (defining international comity as asking courts to balance conflicting public policies between domestic and foreign sovereigns).

189. *See Morrison*, 561 U.S. at 269 (observing that the Commonwealth of Australia, the United Kingdom, and France submitted amicus briefs in the case arguing that applying § 10(b) indiscriminately abroad would interfere with their own countries' securities laws and enforcement).

190. *Id.*; *see also* EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 256 (1991) (reasoning that because Congress did not provide any procedures to reconcile conflicting foreign laws, Congress must not have intended Title VII to apply abroad), *superseded by statute*, Civil Rights Act of 1991 § 109(a), Pub. L. No. 102-166, 105 Stat. 1077, *as recognized in* Arbaugh v. Y & H Corp., 546 U.S. 500, 512–13 (2006).

191. *Morrison*, 561 U.S. at 269.

192. *Id.* at 265, 269.

193. *See, e.g.*, *In re* Banco Santander Sec.-Optimal Litig., 732 F. Supp. 2d 1305, 1317 (S.D. Fla. 2010) (remarking that because plaintiffs invested in Bahamian funds, allowing this case to continue would be an "interference with foreign securities regulation"), *aff'd sub nom.* Inversiones Mar Octava Limitada v. Banco Santander S.A., 439 F. App'x 840 (11th Cir. 2011) (per curiam).

194. *See* Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 215–16 (2d Cir. 2014) (per curiam) (holding that passing *Morrison*'s transactional test was not sufficient to incur § 10(b) liability).

alleviate international comity concerns for the full range of securities and maintain *Morrison*'s presumption against extraterritoriality.

The combination of the transaction and sufficiency tests would help courts better address international comity concerns in two important ways. First, during the sufficiency analysis, courts could look at the economic reality of the instrument.[195] Especially when cases involve unique securities, like derivatives, the economic reality of the instrument would help courts more methodically take into consideration international comity concerns, such as legal and regulatory conflicts. Although the security instrument may facially be a domestic transaction, courts could examine through the economic reality method whether the security functioned as such.[196] If the security in fact functioned more akin to a foreign security, that would count against the court finding the case sufficiently domestic to incur § 10 (b) liability. Second, the totality of the circumstances framework would allow courts to factor in other aspects that directly implicate international comity. For instance, courts could consider whether there is a concurrent investigation in another country, militating against applying § 10(b).[197]

In *Parkcentral*, the swap agreement seemed to be a U.S. security transaction; however, the economic reality of the transaction was more akin to plaintiffs purchasing shares in a foreign company traded on a foreign exchange.[198] Applying U.S. securities law to this transaction would lead to potential conflicts with German securities law.[199] Swaps are contracts between two private parties;[200] the issuer of the referenced security could have no knowledge of these swaps and potentially complied with all local laws.[201] *Morrison*'s holding that § 10(b) had no extraterritorial application would not be followed by

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195. *See supra* Part II.B.2.

196. *See* Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 474, 476 (S.D.N.Y. 2010) (finding that, although the parties may have conducted the transaction in the United States, in economic reality, the transaction was more akin to domestic plaintiffs buying foreign shares of a foreign company on a foreign exchange), *aff'd sub nom. Parkcentral*, 763 F.3d 198.

197. *See Parkcentral*, 763 F.3d at 218 (Leval, J., concurring) (explaining how in reaching its decision, the court considered how German authorities had already investigated the fraud and that the case was pending before a German court).

198. *Elliott Assocs.*, 759 F. Supp. 2d at 474, 476.

199. *See Parkcentral*, 763 F.3d at 216 (noting that German regulatory authorities and courts were already looking into the possible fraudulent acts of Porsche).

200. *Id.* at 205.

201. Brief of Defendant-Appellee Porsche Automobil Holding SE, *supra* note 164, at 33–34.

finding the issuer liable under U.S. securities laws.[202] The case consisted of strong foreign elements.[203] The new two-step extraterritoriality test solves this issue by allowing courts to take international comity into consideration through the economic reality of the security and other factors.

2. The new two-step extraterritorial test will establish a balance between flexible and bright-line rules

Finally, the new two-step extraterritorial test will reinforce *Morrison*'s presumption against extraterritoriality by creating a balance between flexible and bright-line rules. Courts do not want to create a Barbary Coast where fraudsters easily find loopholes for rigid bright-line rules, but courts also do not want to create a Shangri-La where plaintiffs flock to U.S. courts to use an overly flexible rule.[204] Although courts previously considered *Morrison*'s transactional test as a bright-line rule,[205] the Second Circuit in *Parkcentral* held the transactional test was necessary but not sufficient for courts to find § 10(b) applicable.[206]

The new extraterritorial test maintains a level of predictability because the test keeps as its first step the bright-line transactional test of *Morrison*. The transactional test incorporates the Exchange Act's focus on the purchase and sale of securities inside the United States.[207] Under the transactional test, courts and parties know that the security transaction must relate to a security listed on a domestic exchange or a domestic transaction in another security for § 10(b) to apply.[208] The previous test used by courts, the conduct-and-effects test, did not have the same level of predictability.[209] One factor persuading a court to decide that § 10(b) applies in a given case might not persuade another court to decide the same way in another

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202. *See Parkcentral*, 763 F.3d at 215; Brief of Defendant-Appellee Porsche Automobil Holding SE, *supra* note 164, at 24.

203. *Parkcentral*, 763 F.3d at 216.

204. Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 270 (2010).

205. Quail Cruises Ship Mgmt. Ltd. v. Agencia de Viagens CVC Tur Limitada, 645 F.3d 1307, 1310 (11th Cir. 2011) (per curiam) (characterizing *Morrison* as adopting a bright-line test); Calfee, *supra* note 13, at 154 (same); *Second Circuit Holds Transactions Domestic*, *supra* note 5, at 1430 (same).

206. *Parkcentral*, 763 F.3d at 215–16.

207. *Morrison*, 561 U.S. at 266–67.

208. *See id.* at 266; *Parkcentral*, 763 F.3d at 215–16.

209. *See Morrison*, 561 U.S. at 255–56, 258–59 (criticizing, for instance, how courts analyzed the conduct portion of the test differently depending on whether the investors were American or foreign).

case.[210] The Supreme Court in *Morrison* lambasted the lower courts for not consistently applying the presumption against extraterritoriality.[211] However, now under the transactional test, courts maintain the presumption by requiring cases to have the transaction location based in the United States.[212]

Yet, if a court only uses the transactional test, it may end up applying § 10(b) even though the transaction is impermissibly extraterritorial; this is inconsistent with *Morrison*.[213] In the current dynamic financial market, there is constant innovation using the latest technology to create new security instruments.[214] Transaction location is important, as it is the focus of the Exchange Act's provision.[215] However, transaction location is increasingly less determinative of whether a security is domestic or foreign.[216] For instance, using only *Morrison*'s transactional test, parties to swap agreements where the underlying security is traded solely on a foreign exchange would be able to sue foreign companies in U.S. courts as long as they conducted the swap in the United States.[217] The defendants may not have been aware of the swap agreement or even have any connection to U.S. markets, besides third parties using their company's security as the base of their contract price. In contrast, the sufficiency portion of the two-step extraterritorial test provides courts with a flexible method to analyze whether, despite its transaction location, a transaction is sufficiently domestic. The various factors of the test will allow courts to address whether the foreign factors of the case overwhelm the domestic transaction.

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210. *See id.* (same).

211. *Id.* at 255–56.

212. *See id.* at 266–67 (proffering the transactional test).

213. *Second Circuit Holds Transactions Domestic*, *supra* note 5, at 1433 (noting that the location-based focus of the Supreme Court's test can lead to issues because "transactional location is of increasingly limited value").

214. *See* Parkcentral Global Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 217 (2d Cir. 2014) (per curiam) (declining to proffer a specific sufficiency test because in a case of first impression, the court was not equipped to create a test that could easily be applied to the various types of current security instruments and those yet to be created).

215. *See Morrison*, 561 U.S. at 266, 272 (arguing that the focus of the Exchange Act is not on fraud, but fraud in connection with the purchase or sale of a security in the United States).

216. *See* Chambers, *supra* note 146, at 427 (remarking that courts will struggle with determining the location of swap transactions for *Morrison*); *Second Circuit Holds Transactions Domestic*, *supra* note 5, at 1436 (finding this trend in the case of securities-based swap agreements, over-the-counter securities, and American Depository Receipts).

217. *See* Chambers, *supra* note 146, at 427–28 (remarking that the court in *Elliott Associates* reached the correct outcome but with faulty reasoning); Painter, *supra* note 178, at 5–8.

The new extraterritorial test should be a two-step test consisting of *Morrison*'s transactional test and a subsequent factor-based sufficiency test. The economic reality method will be one of the factors of the sufficiency test. By including the economic reality method in the extraterritorial test, courts can more effectively apply *Morrison* to a variety of security instruments. The new two-step extraterritorial test will strengthen *Morrison*'s presumption against extraterritoriality by giving courts more tools to evaluate the foreign elements of cases. Courts can address international comity concerns through the economic reality method and the totality of the circumstances framework. Additionally, the new extraterritorial test strengthens the presumption by establishing a balance between flexible and bright-line rules. This combines the predictable transactional test under *Morrison* with the more flexible sufficiency test, allowing courts to ensure that § 10(b) is not still applied to cases that are impermissibly extraterritorial despite their transaction location.

CONCLUSION

After *Parkcentral*, courts have an opportunity to find a halfway point between the Barbary Coast and Shangri-La. Under the conduct-and-effects test, U.S. courts functioned too much like a Shangri-La where foreign plaintiffs used U.S. courts despite their cases having little actual connection to the United States.[218] The Supreme Court with *Morrison* tried to shift the balance back with the transactional test.[219] However, the test's singular focus on transaction location in the increasingly globalized and technically-advanced markets went too far in the other direction.[220] Thereafter, the Second Circuit in *Parkcentral* added some flexibility into the inquiry with the addition of a sufficiency test.[221] Courts using the second sufficiency test, with the economic reality method as one of the factors, will help U.S. courts keep the integrity of the court system while still having the tools to adequately prosecute U.S. securities law violators.

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218. *See Morrison*, 561 U.S. at 255–56, 258–59 (criticizing, for instance, how courts analyzed the conduct portion of the test differently depending on whether the investors were American or foreign).

219. *See id.* at 267, 269–70 (outlining two factors for determining liability: (1) whether the transaction is conducted in the United States, or (2) whether it involves a security listed on a domestic exchange).

220. *See supra* Part I.A.5.

221. Parkcentral Glob. Hub Ltd. v. Porsche Auto. Holdings SE, 763 F.3d 198, 215–16 (2d Cir. 2014) (per curiam).

Accordingly, courts will first perform the *Morrison* transactional test. Courts will look at whether the case involves a security "listed on domestic exchange[]" or a "domestic transaction[] in other securities."[222] If the case fails either of these tests then the court can dismiss the case for failure to state a claim under Rule 12(b)(6).[223] If the case passes the transactional test, the court will then move on to the sufficiency test. In the sufficiency test, the court will look beyond the transaction location and examine the totality of the circumstances to determine whether § 10(b) applies. The sufficiency test is not a return to the conduct-and-effects test because it is positioned in a different place in the inquiry.[224] The sufficiency test is part of the analysis to determine whether a transaction is sufficiently domestic to warrant § 10(b) liability.[225]

The economic reality method is still viable after the Second Circuit's decision in *Parkcentral*. The Second Circuit did not specifically overrule the method employed by the district court. Moreover, courts have long used economic reality to determine whether unique security instruments fall under the securities laws.[226] However, the district court in *Elliott Associates* was incorrect in using the economic reality method as part of the transactional test.[227] Courts should instead use the economic reality method as one of the factors in the sufficiency test. The inclusion of the economic reality method in the extraterritorial framework will allow courts to more effectively apply *Morrison* to a variety of security instruments.

The new two-step extraterritorial test will help courts maintain *Morrison*'s strong presumption against extraterritoriality. Although the *Morrison* Court developed the transactional test to facilitate this inquiry, the test's singular focus on the location of the transaction can hinder maintenance of the presumption against extraterritoriality in some instances. The test advocated by this Comment will strengthen *Morrison*'s presumption against

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222. *Morrison*, 561 U.S. at 267.

223. *See id.* at 254 (noting that the extraterritorial analysis was a merits question; thus, dismissal of these cases would be under Rule 12(b)(6) and not Rule 12(b)(1)).

224. *See supra* Part II.A.2.

225. *But cf.* Leasco Data Processing Equip. Corp. v. Maxwell, 468 F.2d 1326, 1337 (2d Cir. 1972) (asking whether Congress would have wanted § 10(b) to apply to a case with such foreign elements), *abrogated by Morrison*, 561 U.S. 247.

226. United Hous. Found., Inc. v. Forman, 421 U.S. 837, 848–49 (1975); Elliott Assocs. v. Porsche Auto. Holding SE, 759 F. Supp. 2d 469, 475 (S.D.N.Y. 2010), *aff'd sub nom. Parkcentral*, 763 F.3d 198.

227. *Elliott Assocs.*, 759 F. Supp. 2d at 476.

extraterritoriality by providing courts with more tools to analyze cases with foreign elements. Courts can address international comity concerns through the economic reality method and the totality of the circumstances framework. Additionally, the new extraterritorial test strengthens the presumption by establishing a balance between flexible and bright-line rules.